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In The Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,
v.
DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,
v.
EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF *AMICUS CURIAE* ADAM J. LEVITIN, PROFESSOR OF LAW IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS[1]

Adam J. Levitin is Professor of Law at Georgetown University Law Center, where he teaches courses on bankruptcy, commercial law, and consumer finance, including mortgage lending. Professor Levitin has previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel for Mortgage Affairs to the Congressional Oversight Panel for the Troubled Asset Relief Program. In 2013, Professor Levitin was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin's interest in this case is both as a scholar of bankruptcy law and mortgage finance and because he has authored or co-authored two studies that examine the effect of permitting mortgage lien-stripping on the cost and availability of credit. *See* Joshua Goodman & Adam J. Levitin, *Bankruptcy Law & the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates*, 57 J. L. & Econ. 139 (2014); Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 Wisc. L. Rev. 565.

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[1] Pursuant to Rule 37.6, Amicus affirms that no counsel for a party authored this brief in whole or in part, and that no person other than Amicus and his counsel made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

In *Dewsnup v. Timm*, 502 U.S. 410, 416-17 (1992), the Court recognized the difficulties in a hypothetical application of section 506(d) of the Bankruptcy Code, 11 U.S.C. § 506, "to all possible fact situations" and expressly limited its holding to the facts of that case. The instant cases address a factual situation distinct from *Dewsnup*. Professor Levitin's explanation of the particular legal and economic features of second-lien lending, the structure of the second-lien lending industry, and the empirical scholarship on the impact of bankruptcy law on mortgage lending, will aid the Court's decisional process in applying section 506(d) to the facts of these cases.

SUMMARY OF THE ARGUMENT

Petitioner and its amici present these cases as generally being about secured creditors' rights in bankruptcy; further, they assert that second liens are no different from first liens other than in terms of priority. Accordingly, Petitioner and its amici argue that the Court's analysis in *Dewsnup* should apply with equal force to the cases before the Court and that failing to extend *Dewsnup* to the second-lien mortgage market will upset the market's settled expectations.

Dewsnup, however, was expressly limited to its facts, which involved a partially underwater first-lien mortgage, meaning that the mortgage had a loan-to-value ratio (LTV) of over 100%. Fundamental legal and economic differences between first-lien and second-lien mortgage lending

distinguish the instant cases from *Dewsnup* and suggest that *Dewsnup* should not be extended. Applying *Dewsnup* to cases involving wholly underwater second-lien mortgages would have the perverse effect of enabling Petitioner to do *better* in bankruptcy than it would at state law. Such an outcome would be inconsistent with *Dewsnup*, which was premised on giving the parties only "what was bargained for by the mortgagor and the mortgagee." 502 U.S. at 417. (Parties, of course, always contract against the backdrop of bankruptcy law and the risks it creates.)

Petitioner's arguments about the impact of affirming the decisions below run contrary to all empirical evidence about the effect of lien-stripping in bankruptcy on interest rates. The empirical evidence shows that mortgage lien-stripping in bankruptcy has little or no effect on either interest rates or the availability of mortgage loans. Indeed, the empirical findings make sense because a lender's losses from lien-stripping in bankruptcy are often smaller than a lender's losses in a state law foreclosure. The issue is not zero losses versus losses from lien-stripping, but losses from lien-stripping versus the losses that would obtain in a foreclosure outside of bankruptcy. Moreover, changes in the industrial organization of the mortgage market mean that lien-stripping may often be preferable to mortgage investors, even if not to the banks that service the mortgage loans.

Irrespective of the magnitude of the effect of permitting lien-stripping on interest rates, reversing *Dewsnup* or simply declining to extend it to wholly underwater second-lien mortgage loans is unlikely to affect mortgage markets for a simple reason: the market for high cumulative loan-to-value ratio (CLTV) second-lien mortgages is virtually dead.[2] There is a legacy pool of existing underwater second-lien mortgages, but there is no significant ongoing market that would be affected by permitting lien-stripping on these loans. Given the abuses that occurred in the second-lien mortgage market, this Court should not resuscitate it.

ARGUMENT

I. Legal and Economic Differences Between First-Lien and Second-Lien Mortgages Distinguish This Case from *Dewsnup*.

A. The Particular Type of Second-Lien Mortgages at Issue in This Case Are Almost Entirely Creatures of the Housing Bubble.

The distinguishing feature of a second-lien mortgage loan is that it is secured by a lien that is of second priority. Beyond this basic feature, however, there is significant variation within the

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[2] The CLTV ratio is the sum of the LTV ratios of all mortgages on a property.

second-lien mortgage market. Some second-lien mortgages secure close-end installment loans, while others secure open-end revolving lines of credit known as home equity lines of credit. Some second-lien mortgages are made to borrowers with very good credit, while others are made to "aspirational" or "subprime" borrowers.

The issue in this case concerns primarily close-end (non-revolving) term loans made to subprime borrowers. In contrast, second-lien mortgages made to prime borrowers are often open-end (revolving) home equity lines of credit. Donghoon Lee et al., *A New Look at Second-liens*, 569 Fed. Reserve Bank of N.Y. Staff Rep. 7 at 3 (2012). Prime home equity lines of credit are typically made well after the first-lien loan has been originated, and thus partially paid down. *Id.* at 6. Accordingly, the CLTVs on properties when these home equity lines of credit are fully drawn is typically nowhere close to 100%. Assume, for example, that a borrower with a first mortgage currently at 60% LTV wishes to redo her kitchen, and that interest rates have gone up since the borrower took out the first mortgage. Instead of refinancing at a higher rate, the borrower will simply get an additional mortgage loan, perhaps for another 10% LTV, to cover the costs of the kitchen renovation, resulting in a 70% CLTV. This sort of prime second mortgage is a long-standing product and is unlikely to ever be wholly underwater like the loans in these cases.

During the housing bubble years, a different type of second-lien mortgage arose, the so-called "piggyback." The piggyback second was a loan designed to evade the statutory leverage restrictions on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Company (Freddie Mac). Fannie Mae and Freddie Mac are prohibited, by statute, from purchasing mortgage loans with a LTV over 80%, unless there is first-loss private mortgage insurance covering the loan. 12 U.S.C. § 1717(b)(2); 12 U.S.C. § 1454(a)(2). Private mortgage insurance premiums add to the cost of borrowing. Therefore, to expand market share, some lenders sought to evade the Fannie/Freddie restriction by making two loans to the borrower: one a first-lien loan for 80% LTV, which could be sold to Fannie Mae or Freddie Mac, and then a second-lien loan for as much as 20% LTV These piggyback mortgages substituted for the borrower's down payment, and resulted in a CLTV of 100% on the property, meaning that the borrower would have no equity in the property.

Piggyback second-lien mortgages could not be sold to Fannie Mae or Freddie Mac, 12 U.S.C. § 1717(b)(5)(C); 12 U.S.C. § 1454(a)(4)(C), but they could be securitized in the private-label securitization market[3] or, as was often the case,

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[3] "Private-label" securitization is the issuance of mortgage-backed securities that are not guaranteed by

they remained on the balance sheet of the lender. In either case, the lender might still bear the credit risk on the mortgages, either because the lender owns the loans or because the lender made representations and warranties about the loan's quality and underwriting in the securitization process. Piggyback seconds are associated with higher CLTVs and thus lower down payments. *See* Vicki Been et al., *Sticky Seconds: The Problems Second-liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J. L. & Bus. 71, 81 (2012); Lee et al., 569 Fed. Reserve Bank of N.Y. Staff Rep. at 6-7, 13-14. Higher CLTVs correlate with an increased probability of default. *See, e.g.*, Eduardo S. Schwartz & Walter N. Torous, *Mortgage Prepayment and Default Decisions: A Poisson Regression Approach*, 21 R. E. Econ. 431, 445-46 (2003); Christopher Mayer et al., *The Rise in Mortgage Defaults*, 23 J. Econ. Perspectives 27, 40-43 (2009). Higher CLTVs also correlate with greater loss severities upon default. *See, e.g.*, Min Qi & Xiaolong Yang, *Loss Given Default of High Loan-to-Value Residential Mortgages* (Office of the Comptroller of the Currency, OCC Economics Working Paper 2007-4, 2007).

Respondent Caulkett's second-lien mortgage was a piggyback mortgage. It was made for 20% of the property's value and was made by the same

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Fannie Mae, Freddie Mac, or the Government National Mortgage Association (Ginnie Mae).

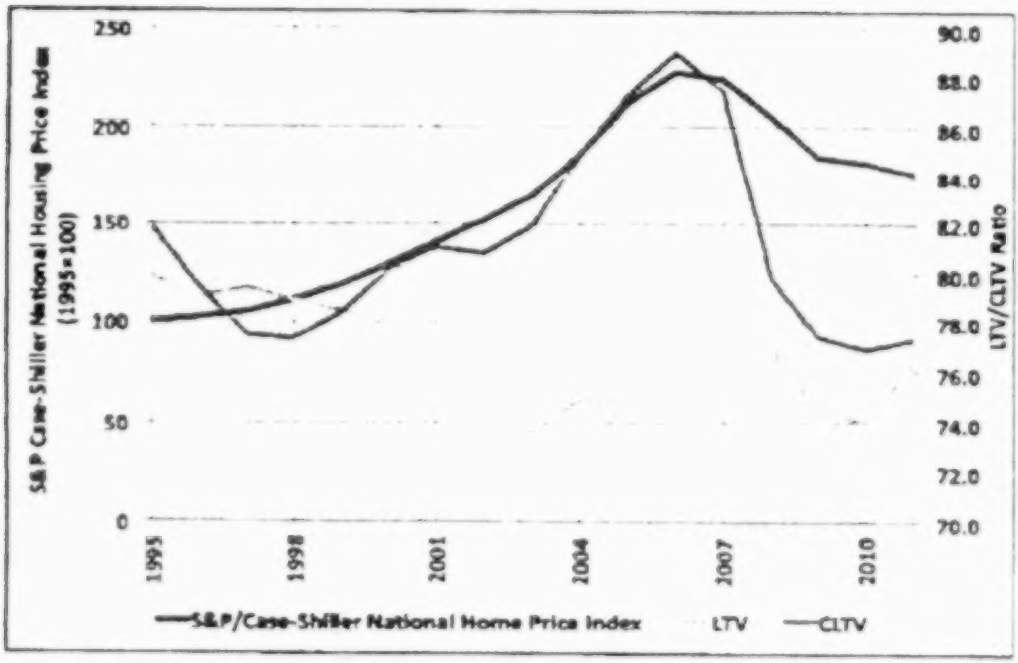
lender (Countrywide Financial) on the same date as the first-lien mortgage made for 80% of the property's value. Together these mortgages *at the time they were made* had a 100% CLTV. Caulkett Opp. Br. at 5-6. At the time Caulkett filed for bankruptcy, the LTV on his first mortgage was 187.5% and the CLTV of the first and second mortgages was 235.8%. *Id.*

Respondent Toledo-Cardona's second-lien mortgage was not a piggyback loan made simultaneously with the first-lien mortgage, but was made subsequent to the first-lien mortgage. Toledo-Cardona's second-lien mortgage was made when Toledo-Cardona already had a first-lien loan for more than 100% of the property's value. Toledo-Cardona Opp. Br. at 5-6. At the time Toledo-Cardona filed for bankruptcy, the LTV on his first mortgage was 174.7%, and the CLTV of the first and second mortgages was 215.9%. *Id.* Toledo-Cardona's second-lien mortgage was apparently an interest-only loan, *id.*, meaning that the principal balance of the second-lien mortgage—and hence the CLTV on the property—was not decreasing with periodic payments.

Second-lien mortgages, such as piggybacks, contributed mightily to the increase in mortgage leverage during the housing bubble. Figure 1 shows that during the housing bubble years of 2003-2007 there was a slight increase in LTVs on first-lien purchase money mortgages, but that the real increase in homeowner leverage was in CLTVs.

An increase in CLTVs, but not first-lien LTVs, indicates that homeowners have increased their mortgage leverage via second mortgages. Figure 1 also shows that the increase in CLTVs (but not in first-lien LTVs) closely tracked the increase in home prices, as increased loan amounts enabled housing prices to be bid up. Not surprisingly, then, homes with junior liens account for over half of the negative equity in the United States. Michael LaCour-Little et al., *The Role of Home Equity Lending in the Recent Mortgage Crisis*, 42 R.E. Econ. 153, 155 (2014).

Figure 1. First-Lien Purchase Money LTV and CLTV Ratios over Time[4]



Formally, the Bankruptcy Code does not distinguish among types of second-lien mortgages, but functionally, the treatment of wholly underwater second-lien mortgages is almost entirely a piggyback mortgage problem associated with the collapse of the housing bubble.

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[4] Adam J. Levitin & Susan M. Wachter, *Second-Liens and the Leverage Option* 13 (Jan. 28, 2015) (unpublished article) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2556687.

B. Second Liens Routinely Become Worthless Under Both State and Federal Law, Unlike First Liens.

1. Foreclosure of a Senior Lien Discharges All Junior Liens, But Foreclosure of a Junior Lien Does Not Affect Senior Liens.

A lien may be released from collateral property in one of three ways: redemption, forgiveness, and foreclosure. Relevant to the instant cases is the release of a lien through foreclosure.

A foreclosure sale discharges the lien of the creditor that commences the sale *and any junior liens* that have been properly notified or joined under applicable law. Restatement (Third) of Property: Mortgages § 7.1 (1997). Therefore, if a first mortgagee brings a foreclosure sale, the sale discharges the liens of the second mortgagee, third mortgagee, etc., *irrespective of whether these junior lienholders have been paid anything from the sale proceeds.*

The junior lienholders are paid only to the extent that the sale proceeds exceed the costs of the sale and the first-lien. Restatement (Third) of Property: Mortgages § 7.4 (1997). The former junior lienholder may still bring an action on the debt, but many states have limitations on the ability to do so, either because the loan was non-recourse or because of restrictions on foreclosure deficiency judgments.

In contrast, a foreclosure sale by a junior lienholder does not affect the liens of any senior lienholders. Restatement (Third) of Property: Mortgages § 7.1 (1997). Those *liens* remain attached to the property in the hands of the foreclosure sale purchaser, even though the *debt* is still owed by the original borrower. Thus, if the debt is not paid by the original borrower, the senior lienholder(s) can foreclose and take the property away from the purchaser at the junior lienholder's foreclosure sale.

Consider, for example, a home worth $150,000 and secured by a first mortgage for $100,000 and a second mortgage for $20,000. If the second mortgagee forecloses, the buyer will receive a home worth $130,000, but subject to a $100,000 first mortgagee's lien. The debt, however, is still owed by the original borrower. Therefore, unless the *buyer* pays off the $100,000 first mortgage owed by the original borrower, the first mortgagee will foreclose on its mortgage and deprive the *buyer* of the property._Therefore, the buyer will rationally

discount its maximum bid by $100,000, the amount of the first mortgage loan. Thus, the maximum bid at the second mortgagee's foreclosure sale would be $50,000.

This means that the legal rights of a second mortgagee are fundamentally different from those of a first mortgagee. The first mortgagee's lien can be discharged only if the debt owed to the first mortgagee is repaid or if the first mortgagee brings a foreclosure sale itself, which it will only do if it believes that the sale proceeds will exceed the costs of the sale. The first mortgagee cannot be deprived of its lien under non-bankruptcy law absent its consent.

In contrast, a second mortgagee's lien can be discharged as the result of a foreclosure by the first mortgagee, without the second mortgagee receiving any of the foreclosure sale proceeds. The second mortgagee's lien is thus at the mercy of the first mortgagee. If the second mortgagee's lien is wholly underwater and the first mortgagee forecloses, the second mortgagee will get nothing.

Furthermore, because a foreclosure by a junior mortgagee does not discharge senior liens, junior mortgagees rarely bring foreclosure actions. This is particularly true for underwater properties. Consider, for example, a home worth $150,000 and secured by a first-lien mortgage for $160,000 and a second-lien mortgage for $40,000. The winning bid at the second-lien foreclosure sale would receive a $150,000 home subject to a $160,000 first-lien

mortgage. No rational bidder would bid for such a property. Accordingly, the second-lienholder would never bring a foreclosure and incur the sale expenses for a sale at which it knows no one will bid.

Indeed, at least one state actually forbids junior mortgagees from bringing foreclosure sales if the sale price would be insufficient to satisfy all obligations secured by senior liens. *See* La. Code Civ. Proc. Ann. art. 2335, 2337. Other states require bidding at a foreclosure sale to start at two-thirds of the newly appraised value of the property. *See, e.g.*, Ark. Code Ann. § 18-50-107(b)(3); Ky. Rev. Stat. Ann. § 426.530 (one-year post-sale right to redeem at sale price, if sale price less than two-thirds of appraised value); La. Code Civ. Proc. Ann. art. 2336 (on first offering property may not be sold for less than two-thirds of appraised value); N.M. Stat. Ann. § 39-5-5 (no property to be sold in foreclosure for less than two-thirds of appraised value); Ohio Rev. Code Ann. § 2329.20 (no property to be sold in foreclosure for less than two-thirds of appraised value); Okla. Stat. tit. 12, § 762 (no property to be sold in foreclosure for less than two-thirds of appraised value). In such cases, no bidder will bid on a sale brought by a junior mortgagee if the first-lien is for more than two-thirds of the property's value.

2. A Wholly Underwater Second Lienholder Receives No Distribution from a "Free and Clear" Sale in Bankruptcy.

Irrespective of section 506(d), a completely underwater second lien can be functionally (if not formally) wiped out in bankruptcy by a "free and clear" sale under section 363(f) of the Bankruptcy Code. Section 363(f) permits the bankruptcy estate to sell assets "free and clear" of creditor's interests in the assets, such as liens under certain conditions. The purchaser in a 363(f) sale takes the assets free of the creditors' liens; the liens instead attach to the proceeds of the 363(f) sale. *See* 11 U.S.C. §§ 363(e), 361, 1129(b)(2)(A)(ii), 1206. The liens thus continue to exist, but the lienholders' recovery will be limited by the extent of the sale proceeds. If a lien is wholly underwater, the proceeds from the sale of the collateral will be insufficient to satisfy a lien, and the lienholder will get no recovery from the sale, just as would occur in a foreclosure sale outside of bankruptcy. Such a wholly underwater lienholder could still recover from the bankruptcy estate's unencumbered assets as a general unsecured creditor.

Two conditions for a "free and clear" sale are applicable to the instant cases. First, under section 363(f)(3), an asset can be sold free and clear of liens if the sale price "is greater than the aggregate value of all liens on such property" 11 U.S.C. § 363(f)(3). Lower courts are split on the

interpretation of this provision, but the view that has "prevailed in practice" is that section 363(f)(3) requires only that the sale price be greater than the fair market value of the liens, rather than greater than the amount of the debt secured by the liens. *See, e.g., In re Boston Generating, LLC*, 440 B.R. 302, 333 (Bankr. S.D.N.Y. 2010); Collier on Bankruptcy ¶ 363.06. Under this reading, a bankruptcy court could order the sale of a property encumbered by both a first mortgage and a wholly underwater second mortgage without the second mortgagee receiving *any* distribution on account of the sale. (The second mortgagee would have a general unsecured claim in the bankruptcy that might receive a distribution from the estate's other assets.)

Second, under section 363(f)(5), an asset can be sold free and clear of liens if the lienholder "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." 11 U.S.C. § 363(f)(5). A junior lienholder could be compelled to accept monetary satisfaction of its interest in a foreclosure by a senior lienholder, *see, e.g., In re Jolan, Inc.*, 403 B.R. 866, 869 (Bankr. W.D. Wash. 2009), and presumably also in an eminent domain action. Again, a wholly underwater second mortgagee would lose its lien without receiving any distribution on account of the lien.

Thus, a completely underwater second-lienholder would get nothing if the bankruptcy

estate sold the home in a 363(f) sale under either section 363(f)(3) or 363(f)(5). Section 363(f), then, enables the bankruptcy estate to force through a "short sale" for less than the amount of the debt secured by the property. As such, "the pre-Code rule that liens pass through bankruptcy unaffected," *Dewsnup*, 502 U.S. at 417, has not survived intact, as least as applied to junior liens. Under the 1978 Bankruptcy Code, the claim that liens necessarily pass through bankruptcy unaffected is at best an overstatement and at worst demonstrably false. To that extent, then, the Court is indeed "writing on a clean slate." *Id.*

3. Unlike Second-Lien Mortgages, First-Lien Mortgages Cannot Be Wholly Underwater.

First-lien mortgages also cannot end up entirely underwater absent the most unusual circumstances. For a first-lien mortgage to end up *entirely* underwater, not only would any structure on the property have to be destroyed, but the land itself would have to have no value. First-lien lenders virtually always require property insurance and have the contractual right to force-place insurance if the borrower lets the insurance lapse. *See, e.g.*, Fannie Mae & Freddie Mac, Form 3044, Uniform Security Instrument § 5 (2015).

Thus, typically only in the most unusual circumstances relating to severe environmental contamination or complete and permanent flooding

would a first-lien lender find itself *wholly* unsecured.

In contrast, a second-lien mortgage could easily find itself wholly underwater, if property values shift. A second-lien lender cannot rely on its loan being partially, much less fully, secured.

In the instant cases, Petitioner's predecessors in interest made loans that were at least partially underwater the minute they were made. The loan made to Respondent Caulkett was a piggyback loan for 100% CLTV Caulkett Opp. Br. at 5-6. Given sale and moving costs, the second mortgage on Caulkett's property was underwater from the beginning. Similarly, the second mortgage on Respondent Toledo-Cardona's property was voluntarily re-subordinated to a refinanced first mortgage that may itself at the time have been for more than the property's value. Toledo-Cardona Opp. Br. at 5-6. In neither case were Petitioner's predecessors in interest relying on property value for recovery of their loans. Instead, they were relying on "hostage" or "hold out" value to compel repayment.

C. Underwater Second-lien Lenders Seek to Recover from Hostage Value Rather Than from Property Value.

A second-lien mortgage lender cannot rely on being even partially secured, cannot rely on the ability to foreclose as a means of repayment, and cannot even count on having a lien because the lien

can be discharged if the first-lien lender forecloses. This means that second-lien lenders have to operate on a different economic model than first-lien lenders. Second-lien lenders aim to be repaid voluntarily by the borrower, but if the borrower does not repay, the second-lien lenders seek to be repaid by being squeaky wheels. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 82.

Thus, if the borrower wanted to refinance the first-lien mortgage, the second-lien lender could block the refinancing by refusing to re-subordinate its lien to the new lien securing the refinanced loan. Since 2009, the Federal government's Home Affordable Refinance Program (HARP) has subsidized refinancings of underwater mortgages owned or guaranteed by Fannie Mae or Freddie Mac. HARP, however, requires a second-lien lender to agree to be re-subordinated before the borrower can receive the government-subsidized refinancing of the partially underwater first-lien mortgage. Fannie Mae, Home Affordable Refinance (DU Refi Plus and Refi Plus) FAQs 3 (2013), *available at* https://www.fanniemae.com/content/faq/harp-du-refi-plus-faqs.pdf; Fannie Mae, 2015 Selling Guide, § B5-5.2-01 (2015); Freddie Mac, Single-Family Seller/Servicer Guide § A24.3 (2014). Second mortgage lenders often demand payments for re-subordination. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 99; Christopher Mayer et al., *A New Proposal for Loan Modifications*, 26 Yale J. on Reg. 417, 419 (2009).

Similarly, second-lien lenders can block "short sales," in which a borrower sells the house for less than the full amount of the first-lien mortgage loan, with the deficiency being forgiven. The second-lien lender can insist on exercising its "due on sale" clause in such a situation, thereby torpedoing the "short sale" unless it is paid off. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 84.

Likewise, second-lien lenders can block a foreclosure alternative known as a "deed in lieu of foreclosure," in which the homeowner simply surrenders the deed to the house to the first-lien lender in exchange for forgiveness of the first-lien debt. If there is a second-lien mortgage on the house, however, the first-lien lender will not want to do a deed in lieu because under the doctrine of merger, the first-lien lender's estates (as owner in fee simple and as first-lien holder) merge into the greater estate of fee simple. *See* Ann M. Burkhart, *Freeing Mortgages of Merger*, 40 Vand. L. Rev. 283, 334-35 (1987). Thus, the first-lien lender would own the property, but subject to the second lien.

Accordingly, without either paying off the second-lien lender or going through the costs of a foreclosure, the first-lien lender will not accept a deed in lieu. Thus, the only potential value in a wholly underwater second-lien mortgage is hostage value.

Indeed, because of the problems underwater second-lien mortgages create for loan restructuring due to their only value being hostage value, the

federal government pays special bounties to second-lienholders as part of the Home Affordable Modification Program (HAMP) for permitting loan modifications or for extinguishing underwater second liens. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 107-09. HAMP addresses the second lien holdout problem using a carrot of government payments.

In contrast, the landmark $25 billion National Mortgage Settlement among 49 states' attorneys general, the federal government, Petitioner, and four other large mortgage servicers, addresses the second lien holdout problem using a stick. The National Mortgage Settlement requires Petitioner and the other large mortgage servicers to reduce the principal balance on second liens whenever there is a principal reduction on a first mortgage. *See* Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361 (D.D.C. Apr. 4, 2012), at D1-1-D1-3; *see also* Been et al., 9 N.Y.U. J. L. & Bus. at 109. The consent judgment also requires that in the case of a short sale or deed in lieu of foreclosure the Petitioner must extinguish any junior lien it holds and forgive the balance secured by that junior lien. *See* Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361 (D.D.C. Apr. 4, 2012), at D7; *see also* Been et al., 9 N.Y.U. J. L. & Bus. at 109.

Whether addressed by carrot or stick, the federal government's actions relating to second mortgages illustrate how the holdout problem can

easily frustrate the attempts of courts and legislators to stabilize the housing market.

D. Bankruptcy Law Disfavors Hostage Value.

Bankruptcy law disfavors hostage value; the fundamental structure of bankruptcy law is designed to reduce holdout value of all sorts. Outside of bankruptcy, a creditor generally cannot be forced to compromise its right to payment. This obviously presents particular difficulties for trying to address the problem of insolvent debtors, who, by definition, cannot repay all of their creditors.

While creditors may refuse concessions outside of bankruptcy, bankruptcy law enables concessions to be forced upon unwilling creditors. Most fundamentally, individual creditors can be bound to a bankruptcy plan irrespective of the creditor's consent. Chapter 7 liquidations and Chapter 12 and Chapter 13 plans do not require any creditor consent whatsoever, while a Chapter 11 plan can be confirmed through majority voting procedures without the consent of all creditors.

Similarly, section 363(f) of the Bankruptcy Code—applicable to all types of bankruptcy—permits assets to be sold "free and clear" of creditors' interests in the assets, including liens. This enables assets to be sold for their market value and not for their value discounted by the amount of the lien(s).

E. Forbidding Lien-Stripping of Wholly Underwater Second Liens Creates a Bankruptcy "Windfall" for Second Mortgagees.

For the reasons Respondents articulate, the Bankruptcy Code's statutory language is properly read not to apply *Dewsnup* to wholly underwater second-lien mortgages. Rather than repeating those (lucid) textual arguments, Amicus seeks to underscore that the legal and economic differences between first-lien and second-lien mortgages differentiate the situation in the instant cases from this Court's decision in *Dewsnup*.

Dewsnup dealt with a partially underwater first-lien mortgage. The instant cases deal with wholly underwater second-lien mortgages, which have substantively different rights under both applicable non-bankruptcy law and under other provisions of bankruptcy law. *Dewsnup* was concerned with upholding "what was bargained for by the mortgagor and the mortgagee." 502 U.S. at 417. Extending that principle to the facts of the instant cases requires affirming the decisions below.

In the instant cases, the Petitioner is requesting that this Court mandate *better* treatment for its wholly underwater second-lien mortgages in bankruptcy than it would receive at state law. Such superior treatment is inconsistent with the principle enunciated in *Butner v. United States* that bankruptcy law primarily creates procedural rights. 440 U.S. 48, 54 (1979). A

bankruptcy should not produce a windfall for an underwater second mortgagee above what the mortgagee would receive in a foreclosure. Given *Dewsnup*'s explicitly narrow holding, Petitioner did not bargain with a reasonable expectation that its liens could not be stripped if they were entirely underwater. *A fortiori*, Petitioner did not bargain for a bankruptcy "windfall" and should not receive one.

II. Empirical Evidence Demonstrates That Affirming the Decisions Below Will Not Disrupt The Settled Expectations of the Mortgage Market.

A. Chapter 13 Lien-Stripping Had a Minimal Effect on Mortgage Credit Costs.

In an empirical study published in a leading peer-reviewed economics journal, Professor Levitin, together with Professor Joshua Goodman of the Harvard Kennedy School of Government, determined that permitting lien-stripping in Chapter 13 bankruptcies resulted in almost no impact on mortgage credit costs. Joshua Goodman & Adam J. Levitin, *Bankruptcy Law & the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates*, 57 J. L. & Econ. 139 (2014). This study suggests that, contrary to the claims of Petitioner and its amici, a decision for Respondents in this case will not disrupt settled expectations.

Between 1978 and the Court's 1993 decision in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), there was a split of authority in the lower courts regarding whether lien-stripping was permitted in Chapter 13 for first-lien mortgages solely on real property that was the debtor's principal residence. (This is sometimes referred to as Chapter 13 "cramdown," not to be confused with the conceptually distinct Chapter 11 "cramdown," which refers to the confirmation of a Chapter 11 plan without the consent of all impaired classes of claims and interests). In *Nobelman*, this Court held unanimously that 11 U.S.C. § 1322(b) prohibited lien-stripping in Chapter 13 on partially underwater first-lien mortgages solely on real property that is the debtor's principal residence. 508 U.S. at 329.

Professors Levitin and Goodman used both the prior split of authority in the lower courts and the subsequent unanimity of authority following *Nobelman* to test the impact of permitting or disallowing lien-stripping on home mortgage interest rates and lending volumes. The timing of the splits in lower court authority allowed Professors Levitin and Goodman to statistically test how a legal rule on lien-stripping affected interest rates. They did this through two "difference-in-differences" analyses, which compare the change in both a test group and a control group following an exogenous event.

The first analysis compared interest rates and lending volumes in judicial districts permitting lien-stripping with districts that did not during the 1978-1993 period. The second analysis looked at the differential effect of the *Nobelman* decision on interest rates and lending volumes in judicial districts that had permitted lien-stripping prior to *Nobelman* compared with districts that had not. In both analyses, Professors Levitin and Goodman statistically controlled for any variation that might occur because of geographic locale or time.

Professors Levitin and Goodman found only very small differences in interest rates and lending volumes based on whether Chapter 13 lien-stripping was permitted. To ensure the results were not dependent on any one statistical analysis, Professors Levitin and Goodman tested their results across several regression models. Depending on model specifications, Professors Levitin and Goodman found an average increase in the cost of credit of only 0.12%-0.16% (12 to 16 basis points). *See* Goodman & Levitin, 57 J. L. & Econ. at 156. This was at a time when average mortgage interest rates were at 8.2%, so an additional 12-16 basis points would translate into around a 1% increase in monthly payments. *Id.* Professors Levitin and Goodman observed larger impacts on borrowers with higher interest rate loans—presumably riskier borrowers—but the magnitude of the impact was still small, namely 0.21% - 0.35% (21-35 basis points). *Id.* at 154.

Professors Levitin and Goodman attribute this small magnitude to several factors, including the rarity of Chapter 13 filings by underwater homeowners relative to the mortgagor population in general, the high percentage of Chapter 13 cases that do not result in completion of a plan and a discharge, and most importantly, the fact that losses from cramdown do not necessarily exceed those in a state law foreclosure. *Id.* at 156.

A subsequent study by researchers affiliated with the Federal Reserve Bank of Philadelphia reached the same conclusions as Levitin and Goodman. *See* Wenli Li et al., *Using Bankruptcy to Reduce Foreclosures: Does Strip-Down of Mortgages Affect the Supply of Mortgage Credit?* (Fed. Res. Bank of Phila. Working Paper No. 14-35, 2014). The Philadelphia Fed study used the same interest rate data used by Goodman and Levitin and employed virtually the same methodology as Goodman and Levitin, but also looked at mortgage application approval data collected under the Home Mortgage Disclosure Act. The Philadelphia Fed study also examined the impact of Chapter 7 lien-stripping decisions and *Dewsnup* as well as Chapter 13 lien-stripping decisions and *Nobelman*.

The Philadelphia Fed study found that permitting Chapter 7 lien-stripping resulted in a 1.8% reduction in mortgage approval, but not to any statistically significant change in interest rates. *Id.* at 14, 20, 29. The Philadelphia Fed likewise found that permitting Chapter 13 lien-

stripping led to a 0.23% (23 basis point) reduction in mortgage interest rates and a 1.1% increase in mortgage approval rates. *Id.* at 15, 20, 30. The Philadelphia Fed study concludes that its results "suggest that introducing mortgage strip-down under either bankruptcy chapter would not have a strong adverse impact on the terms of mortgage loans and could be a useful new policy tool to reduce foreclosures." *Id.* at 20.

Two rigorous empirical studies have found that, historically, permitting lien-stripping has little discernible impact on mortgage credit costs or availability. Neither Petitioner nor its amici are able to cite to *any* research indicating that permitting lien-stripping of wholly underwater second mortgages will have any impact on mortgage lending or the economy more broadly.

B. There Is No Evidence that Lenders Currently Charge Higher Interest Rates to Account for Lien-Stripping Risk.

The Levitin-Goodman study and the Philadelphia Fed study both examined the 1978-1993 mortgage market, not the 2015 mortgage market. Yet, there is reason to believe that these findings would carry over to the current market.

Other current market indicators show that the market does not generally price for lien-stripping risk on properties that can still be lien stripped in Chapter 13. Three circuit courts of

appeals permit lien-stripping in Chapter 13 of wholly-or-partially underwater first mortgages that are not secured *solely* by the borrower's principal residence, but also include other collateral, such as an attached basement apartment or fixtures. *See In re Scarborough*, 461 F.3d 406 (3d Cir. 2006); *In re Thompson*, 77 Fed. Appx. 57 (2d Cir. 2003); *Lomas Mortg., Inc. v. Louis*, 82 F.3d 1 (1st Cir. 1996); *In re Hammond*, 27 F.3d 52 (3d Cir. 1994). And all eight circuit courts of appeals to address the issue have permitted lien-stripping in Chapter 13 of wholly underwater second mortgages. *In re Pond*, 252 F.3d 122, 126 (2d Cir. 2001); *In re McDonald*, 205 F.3d 606, 611 (3d Cir. 2000); *In re Davis*, 716 F.3d 331, 336 (4th Cir. 2013); *In re Bartee*, 212 F.3d 277, 288 (5th Cir. 2000); *In re Lane*, 280 F.3d 663, 667–69 (6th Cir. 2002); *In re Schmidt*, 765 F.3d 877, 881–82 (8th Cir. 2014); *In re Zimmer*, 313 F.3d 1220, 1226 (9th Cir. 2002); *In re Tanner*, 217 F.3d 1357, 1359–60 (11th Cir. 2000). *But cf. In re Woolsey*, 696 F.3d 1266, 1272 (10th Cir. 2012) (reserving interpretation of § 1322(b)(2) "and its meaning for another day" because petitioner refused to argue it).

Despite this difference in lien-stripping risk, there is no observable difference in pricing of private mortgage insurance based on whether properties are potentially subject to lien-stripping. *See* Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 Wisc. L. Rev. at 593-596. Similarly, no pricing difference can be observed based on

property type (and hence Chapter 13 lien-stripping risk) in either the primary mortgage market, *id.* at 586-93, or the guarantee fees charged by Fannie Mae and Freddie Mac in the secondary market. *Id.* at 597-98.

C. Lenders Are Unlikely to Charge Higher Interest Rates to Account for Lien-Stripping Risk if Bankruptcy Judges' Valuations Are Correct.

1. There Is No Reason to Believe Judicial Valuations Are Lower than Foreclosure Sale Prices.

There was no evidence of adverse pricing based on lien-stripping risk in the 2009 mortgage market for a simple reason: the alternative to lien-stripping is not payment in full, but the recovery the lender could get in a state law foreclosure proceeding or out-of-court loan restructuring.

Unless bankruptcy courts systematically undervalue properties, there is no reason to think that lenders would have larger recoveries in state law foreclosure proceedings. Wholly underwater mortgages simply get wiped out in state law foreclosure sales with zero recovery, so lien-stripping in bankruptcy is no worse of an outcome.

2. Judicial Valuation Is Essential to the Functioning of the Bankruptcy System.

There is no reason to believe that bankruptcy courts do a poor job at valuations,

particularly for relatively simple assets such as single-family residences. Similarly, there is no reason to think that bankruptcy judges are biased in one direction or another on valuation issues. Indeed, the United States bankruptcy system is generally considered the finest in the world; other countries seek to emulate the United States bankruptcy system.

Judicial valuation is the very heart of the bankruptcy enterprise. Numerous provisions of the Bankruptcy Code require judicial valuation. Contrary to Petitioner's claims, the Bankruptcy Code does not display an "aversion" to judicial valuation; neither the Bankruptcy Code nor this Court have ever required a market test for an asset's valuation in lieu of judicial valuation.

For example, the bankruptcy court must undertake a valuation to determine whether a creditor is entitled to "adequate protection" of its interest in the debtor's property under 11 U.S.C. § 361, pursuant to either 11 U.S.C. §§ 362, 363, or 364(d), and how much the adequate protection should be. This is never done through a market test. Likewise, a bankruptcy court must undertake a valuation to approve a free-and-clear sale under section 363(f)(3). Again, no market test is invoked.

More generally, bankruptcy courts must undertake valuations to determine the reasonableness of any section 363 sale or lease or to determine if a pre-petition transfer was constructively fraudulent under 11 U.S.C. §§ 544(b)

and 548. Bankruptcy courts must also undertake valuations to determine whether and the extent to which a claim is unsecured under 11 U.S.C. § 506. Likewise, confirmation of a Chapter 9 or Chapter 11 cramdown plan or a Chapter 12 or 13 plan of any sort requires the bankruptcy court to value the payments made to secured creditors to determine if their present value is equal to the allowed amount of the secured claim on the effective date of the plan or is the indubitable equivalent thereof. 11 U.S.C. §§ 901(a), 1129(b)(2)(A)(i), 1129(b)(2)(A)(iii), 1225(a)(5)(B), 1325(a)(5)(B). Absent confidence in the ability of bankruptcy courts to undertake valuations, the entire bankruptcy system falls apart.

3. Valuations in the Instant Cases Are Not in Dispute.

The facts of the instant cases show that there is no real concern over valuation issues. Petitioner did not dispute the valuation of either property. Both of Respondents' second-lien mortgages were deeply underwater. Respondent Caulkett's home was valued at $98,000 and was encumbered with a first-lien mortgage for $183,264 and a second-lien mortgage for $47,855. Caulkett Opp. Br. at 6. Likewise, Respondent Toledo-Cardona's home was valued at $77,689, but was encumbered with a first lien mortgage of $135,703 and a second-lien mortgage of $32,000. Toledo-Cardona Opp. Br. at 6.

In both cases, the bankruptcy court would have to have erred in its valuation of Respondents' properties by fifty percent for Petitioner to have been "in the money" by as much as a penny. On these valuations, Respondents' properties would have to *double* in value for Petitioner's mortgages to *ever* be back in the money.

In most situations, like these cases, there will be no question whether the second-lien mortgage is wholly underwater; valuations will not be close to the total amount due under the first-lien mortgage. In those few close cases, the parties are likely to settle rather than risk a judicial valuation. Thus, concerns about inaccurate judicial valuation are a red herring.

D. The Market Will Not Price Adversely to Judicial Lien-Stripping Because Bankruptcy Can Create Value for First-Mortgagees.

Yet another reason the market is unlikely to price adversely to the risk of judicial lien-stripping is that (counter-intuitively) bankruptcy may in fact create value for first mortgagees. The baseline against which mortgagees evaluate bankruptcy is not a world of no losses, but a world of foreclosure sales and loan restructurings. Relative to foreclosure sales and loan restructurings, bankruptcy offers a number of advantages.

First, as long as the debtor is in bankruptcy, the lender is able to receive adequate protection of

its interest in the property. 11 U.S.C. §§ 361, 362(d)(1).

Second, if the property is sold in bankruptcy rather than through a state law foreclosure sale, it is likely to result in a greater recovery for the lender. Foreclosure sales are done without marketing aside from judicial notice advertisement. Foreclosure sales also occur without a showing of the property to prospective buyers; because the property remains the borrower's until the foreclosure sale is closed, prospective buyers lack a pre-sale right of entry and inspection. The result is to depress foreclosure sale prices because of prospective buyers' informational disadvantages. A bankruptcy sale under section 363 can produce a higher sale price because the property can be marketed as if it were an arm's length private sale, with full inspection rights for potential buyers. 11 U.S.C. § 363.

Likewise, several states allow buyers a statutory post-sale right of redemption; in some states this post-sale right of redemption extends for up to two years. *See, e.g.*, Ala. Code § 6-5-248(b) (one-year right of redemption); Tenn. Code § 66-8-101 (two-year right of redemption). Post-sale statutory rights of redemption depress foreclosure sale prices because buyers cannot obtain clean title until the expiration of the statutory redemption period. A sale under section 363 of the Bankruptcy Code would not be subject to state law rights of redemption that are triggered only by state

foreclosure sales. Cutting off the statutory post-sale right of redemption increases buyer certainty of sale finality and thus sale prices.

Not only is judicial valuation central to bankruptcy, *supra*, section II.C.2., but it is a far better valuation methodology than the alternative of foreclosure sales, which this Court has recognized have an uncontroverted and uncontestable downward valuation bias. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994).

Third, as discussed in the following section, bankruptcy enables a circumvention of the principal-agent problem that can exist between mortgage lenders and their servicing agents. Because bankruptcy can actually *create* value for lienholders, they might not price adversely to lien-stripping risk.

E. Permitting Judicial Lien-Stripping Helps Overcomes Agency Problems in Mortgage Servicing.

An additional reason why the market may not price adversely to the risk of lien-stripping is that lien-stripping solves a principal-agent problem in the mortgage industry. During the 1978-1994 period, most mortgage loans were financed by depositories' balance sheet lending: banks and thrifts would make loans and hold them.[5] Since 1995, however, most residential mortgage loans are financed through securitization.[6] This means that the loans are sold to specially-created trusts that pay for the loans by issuing debt securities known as mortgage-backed securities.

Securitized loans still need to be managed on a day-to-day basis, however. Monthly invoices need to be mailed, payments collected from mortgagors and remitted to the holders of the mortgage-backed securities, payoff statements and escrow balances generated, and defaults managed. This day-to-day management of the loans is handled by entities known as mortgage servicers.[7] The servicers

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[5] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[6] *Id.*

[7] Servicers are often the original lenders. The original lenders will sell the mortgage loan, but retain the servicing rights and revenue.

function as agents for mortgage-backed securities investors, but those investors have little ability to oversee or discipline the servicers. *See* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 7, 58-63 (2012).

Servicers are paid *before* the mortgage-backed securities investors, making them essentially the senior creditors of the trusts that issue the mortgage-backed securities. *See id.* at 70. The result is that servicers' incentives are frequently not aligned with those of investors; servicers are often incentivized to foreclose on loans when a restructuring, potentially including principal reduction, would maximize value for investors. *Id.* at 5, 76; *see also* Katherine M. Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121, 126 (2008).

Lien-stripping in bankruptcy accomplishes a restructuring without consent of the servicer. While servicers may not like this, restructuring is often in the interest of the mortgage-backed securities investors, which is why the mortgage market does not price adversely to the risk of lien-stripping. Lien-stripping enables value-maximizing restructuring in the face of a principal-agent problem in loan servicing.

Beyond the empirical evidence, there are a multitude of reasons to doubt that there will be any adverse market reaction to affirming the decisions below. First, liens have been stripped off of wholly underwater second mortgages in Chapter 7 for

some time now in the 11th Circuit without there being an "enormous and unwarranted disruption of settled expectations" in markets. Pet'r's Br. at 44.

Second, liens have been stripped off of wholly underwater second mortgages in Chapter 13 for some time now in eight circuits, *see* section II.B, *supra*, without there being an "enormous and unwarranted disruption of settled expectations" in markets. Pet'r's Br. at 44.

Third, liens have always been stripped off of wholly and partially underwater loans of almost all types in Chapter 11. This has never caused any sort of market disruption, as markets are capable of pricing for this risk.

Indeed, neither Petitioner nor its amici are able to point to *any* sort of evidence of market disruption caused by lien-stripping. There is no reason to think that the U.S. housing finance market—one of the largest and most liquid markets in the world—cannot easily adjust to a very particularized type of bankruptcy risk on wholly underwater second-lien mortgages, particularly because the type of loan at issue simply is not made any more, as discussed in Section III, below.

F. Petitioner's Litigation to Protect Utterly Worthless Liens is Puzzling.

Given how deeply underwater the second mortgages are in the instant cases, it is puzzling why Petitioner is litigating the issue. Even if Petitioner were to prevail before this Court, its

liens would still be deeply underwater. Florida real estate prices would have to *double* for either of Petitioner's mortgages to even "break the waterline." If the Respondents' first mortgage lenders were to foreclose before such an astonishing market rebound, Petitioner would have no recovery from its mortgages. The primary effect of a favorable ruling for Petitioner would not be the preservation of the value of these worthless liens; rather, it might allow Petitioner and similarly situated banks to delay loss recognition on their bad loans.

Banks like Petitioner are subject to minimum regulatory capital requirements based on the value of the bank's assets. *See* 12 U.S.C. § 1831o (requiring minimum capital standards); 12 C.F.R. § 3 (regulatory implementation of capital standards for national banks). A borrower's bankruptcy filing can trigger regulatory accounting rules that require a bank to write down the loan on its books. Federal Financial Institutions Examination Council, *Uniform Retail Credit Classification and Account Management Policy*, 65 Fed. Reg. 36903, 36904 (June 12, 2000). If a bank's net asset value falls too low, the bank will have to raise additional capital to comply with regulatory capital requirements and thus dilute its existing shareholders' equity. To the extent that loss recognition can be delayed, however, losses can be offset by retained earnings, thereby avoiding the need to raise additional capital and dilute existing shareholders.

Petitioner's financial situation illuminates the magnitude of this effect. As of the end of the third quarter of 2014, Petitioner held over $87 billion in junior mortgages.[8] This is the largest portfolio of junior mortgages of any financial institution in the United States,[9] and accounts for nearly 6% of Petitioner's assets. *Id.* Seventeen percent of these junior mortgages were underwater. *See* Bank of America, Quarterly Report (Form 10-Q) 92 & tbl. 37, 171 (Nov. 6, 2014). As of the fourth quarter of 2014, Petitioner had loss reserves equal to 3.95% of its junior mortgage portfolio, meaning it is carrying its junior portfolio at over 96 cents on the dollar. *Id.* at 87. *See also* Been et al., 9 N.Y.U. J. L. & Bus. at 95 (observing the same in 2011).

If debtors in all circuits could strip off wholly underwater junior liens, then Petitioner and similarly situated banks might have to recognize losses on much more of their wholly underwater junior mortgages sooner than they otherwise would. In other words, this case will not affect the "settled expectations" of markets, Pet'r's Br. at 44, but whether Petitioner and similarly situated banks will have to dilute their shareholders' equity.

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[8] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[9] Kathleen Howley & Dankin Campbell, *Bank of America Faces Bad Home Equity Loans: Mortgages*, Bloomberg Business, Apr. 18, 2012.

III. The Second-Lien Mortgage Lending Market Is Near Dead and Should Not Be Resuscitated.

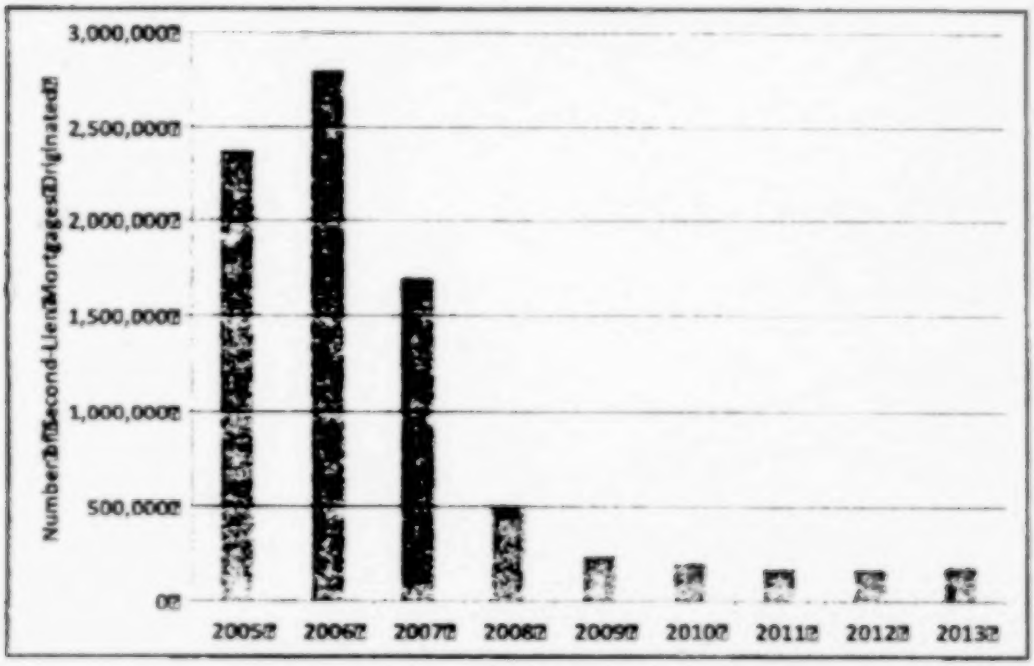
There is further cause to believe that the economic effect of permitting lien-stripping for wholly underwater second mortgages is likely to be minimal: since the implosion of the housing bubble, second-lien loans with high CLTVs are rarely (if ever) made. Second-lien mortgages in general "have now all but disappeared." Laurie Goodman et al., *Where Have All the Loans Gone? The Impact of Credit Availability on Mortgage Volume*, 20 J. Structured Fin. 45, 46 (2014); *see also* Lee et al., *A New Look at Second-liens*, 569 Fed. Reserve Bank of N.Y. Staff Rep. 7 at 28.

There were less than 200,000 second-lien mortgages of all types originated in 2013.[10] In contrast, during the height of the bubble nearly a decade ago, there were over 2.8 million second-lien mortgages made. *See* Robert B. Avery et al., *The 2006 HMDA Data*, 93 Fed. Res. Bulletin A73, A82 (Dec. 2007).

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[10] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

Figure 2. Number of Second-Lien Mortgages Originated by Year[11]

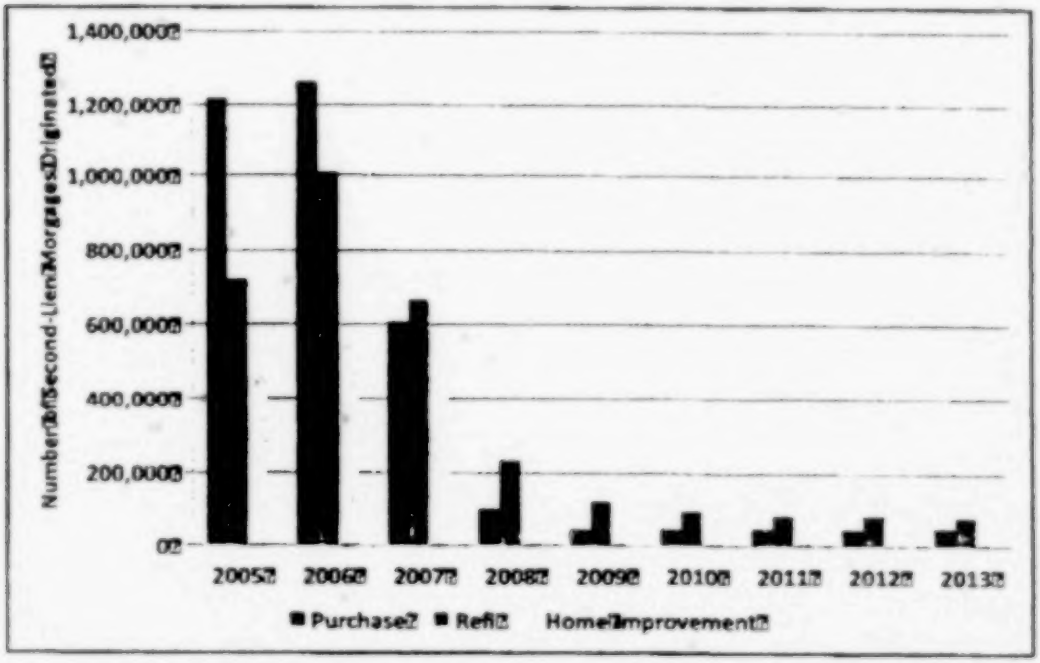


Of the second mortgages originated in 2013, 38% were home improvement loans, which generally have low CLTVs. In contrast only 19% of the second mortgages originated in 2005 or 2006 were home improvement loans; most were piggyback purchase money loans. High-CLTV second-lien lending is a creature of the past. *See* Bonnie Sinnock, *Second Liens Grow Again as Other Mortgage Lending Dwindles*, Nat'l Mortg. News, July 31, 2014.

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[11] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

Figure 3. Number of Second Lien Mortgages Originated by Year by Loan Purpose[12]



The situation in the instant cases is a singular product of the 2003-2007 housing bubble. Subsequent regulatory and market changes mean that high CLTV second-lien mortgages are rarely made any more and are unlikely to be in made in the future.

The high CLTV second-lien mortgage market has disappeared because of a combination of regulatory and market conditions. New mortgage market regulations make it difficult to make high

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[12] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

CLTV second-lien mortgages. Current law prohibits the making of mortgage loans without verification of the borrower's ability to repay the loan. *See* 15 U.S.C. § 1639c. While the regulatory implementation of the ability to repay requirement does not have a LTV component, it will effectively limit most high CLTV lending because high CLTV lending correlates with other risk characteristics covered by the implementing regulation, such as high debt-to-income ratios, lack of full amortization, and prepayment penalties.

Beyond regulation, there is no financing for making high CLTV second mortgage loans. The mortgage market's collapse in 2007 and the following years severely chastened mortgage lenders and mortgage investors. There simply is no financing for high CLTV seconds. Banks do not want to incur the risk on their balance sheets, and Fannie Mae and Freddie Mac are prohibited from purchasing high CLTV seconds.

The other possible financing channel, private-label securitization, which provided the high-octane financing for the housing bubble, has been virtually moribund since 2008. In 2006, private-label securitization funded 43% of all residential mortgage originations in the United States or more than $1.17 *trillion* of mortgages per year. [13] In contrast, in 2014, private label securitization funded a mere $5.58 *billion* of mortgage originations.[14] Over 99.5% of the private-label securitization market has disappeared since the bubble. Only 7,250 mortgages nationwide were funded by private-label securitization in 2014.[15]

The lack of financing for high CLTV second mortgages is unlikely to change in the foreseeable future because there is no market appetite for the credit risk involved in such lending. It is hard to conceive of super-risky mortgages like the ones the Petitioner made to Respondents being made in today's more sober lending environment. This Court should not give succor to the revival of such destructive lending.

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[13] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[14] *Id.*

[15] *Id.*

CONCLUSION

For the aforementioned reasons, Amicus Curiae Adam J. Levitin respectfully submits that the instant cases should not be controlled by *Dewsnup v. Timm* and that the 11th Circuit's judgments should be affirmed.

Respectfully submitted,

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